Appendix "A"

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In the United States District Court for the Northern District of California, Southern Division

Joe R. Ramos and Mary Ramos, Plaintiffs, vs. United States of America, Defendant.	Civil Actions No. 40033 and No. 40202

MEMORANDUM OPINION AND ORDER

The instant cases were brought by the plaintiffs, Joe R. and Mary Ramos, under Section 1346(a)(1) of Title 28, United States Code, to obtain refunds of federal income tax and interest which they allegedly overpaid. In Civil Action No. 40202, the plaintiffs seek to recover tax and interest totaling $66,797.77, paid for the calendar year 1956, plus interest allowed thereon by law. In Civil Action No. 40033, they seek to recover tax and interest totaling $55,182.04, paid for the calendar year 1957, plus interest allowed thereon by law. These cases were consolidated for trial and tried to the Court sitting without a jury.

The issues of fact and of law as framed by the pretrial order of these consolidated cases and as approved by plaintiffs and defendant are as follows:

A. ULTIMATE ISSUES OF FACT:

(1) Whether or not a valid family partnership composed of the plaintiffs and their children, Dolores Donaldson and Joe S. Ramos, was in existence and conducted and operated during the calendar year 1956 in connection with orchard and farming activities on the "Ramos Home Ranch."

(2) Whether or not a valid family partnership composed of Joe R. Ramos and his children, Dolores Donaldson and Joe S. Ramos, was in existence and conducted and operated during the calendar year 1957 in connection with orchard and farming activities on the "Ramos Home Ranch".

B. ISSUES OF LAW:

(1) If the Court finds that a valid family partnership was in existence during the calendar year 1956, was the sum of $70,640.48 received in that year from crops sold during the calendar year 1955 (at a time when there was no partnership) taxable to the members of the 1956 partnership or to the plaintiffs.

(2) If the Court finds that a valid family partnership was in existence during the calendar year 1957, was the sum of $157,088.71 received in that year from crops sold during the calendar

year 1956 taxable to the members of the 1957 partnership or to the members of the 1956 partnership (assuming that the Court finds that a valid family partnership was in existence for the calendar year 1956) or the plaintiffs (assuming that the Court finds that no valid family partnership was in existence for the calendar year 1956).

Additional questions which must be resolved as they relate to the amount of refund to which plaintiffs may be entitled are:

(1) If a partnership is found for 1956, must the corrected income thereof be adjusted to provide for the elimination of deductions for depreciation and property taxes.

(2) If a partnership is found for 1956, must the corrected income thereof be reallocated to credit plaintiffs with a reasonable salary for services rendered by plaintiff Joe R. Ramos.

(3) If a partnership is found for 1956, must the corrected income thereof be reallocated to credit plaintiffs with the reasonable rental value of the land, trees and equipment used in the production and harvesting of their crops during this year.[1]

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[1]The alternative to a correction of the 1956 partnership income by a reallocation of the credit due plaintiffs for the reasonable rental value of the land, trees and equipment would be a reallocation of the credit due plaintiffs as a return on their capital. In the circumstances of this case, since neither the land, trees or equipment ever became partnership assets and all that the partnership received was the use thereof, such use may be more appropriately treated and described as a rental (as was the case for the calendar year 1957) and is so treated for the purposes of these proceedings.

(4) Did the absence of Joe S. Ramos in 1956 and for nine months of 1957 due to military service[2] affect the distributive share of the partnership income to which he would have been entitled but for such absence.

(5) If a partnership is found for 1957, must the corrected income thereof be reallocated to credit plaintiffs with a reasonable salary for services rendered by the plaintiff Joe R. Ramos.

Plaintiffs were credited with the reasonable rental value of the land, trees and equipment for 1957 (25% of the crop income), hence, subject to such adjustment as must be and will be hereinafter made because the partnership operated on a cash basis, no problem of reallocation of this item for this year arises.

The Court's answers to the issues of fact and law framed by the pre-trial order and the above additional questions, for the reasons hereinafter stated, are:

(1) A valid family partnership composed of plaintiffs, Joe R. and Mary Ramos, and their children, Dolores Donaldson and Joe S. Ramos, was in existence and conducted and operated during the calendar year 1956 in connection with almond orchard and farming activities on the "Ramos Home Ranch".

(2) A valid family partnership composed of Joe R. Ramos and his children, Dolores Donaldson and

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[2]Section 704(e)(2) of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed. Sec. 704(e)(2)) provides in part: "The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service." An identical provision appeared in Section 191 of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed. Sec. 191).

Joe S. Ramos, was in existence and conducted and operated during the calendar year 1957 in connection with almond orchard and farming activities on the "Ramos Home Ranch".

(3) The sum of $70,640.48 received in the year 1956 from crops sold during the calendar year 1955[3] was taxable to the plaintiffs.

(4) The sum of $157,088.71 received in 1957 from crops sold during the calendar year 1956 was taxable to each of the members of the 1956 partnership in equal shares.

(5) The corrected income of the partnership for 1956 must be adjusted to provide for the elimination of deductions for depreciation and property taxes in the sum of $9,623.68 (depreciation $7,596.88 and taxes $2,026.80).

(6) The corrected income of the partnership for 1956 must be reallocated to credit plaintiffs with a reasonable salary for services rendered by plaintiff, Joe R. Ramos, which the Court finds to be and fixes in the sum of $4,200.00 ($350.00 times twelve months).

(7) The corrected income of the partnership for 1956 must be reallocated to credit plaintiffs with the reasonable rental value of the land, trees and equipment used in the production and harvesting of their crops during this year, which the Court finds to be

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[3]Although the family partnership was formed in about June of 1955, and the son, Joe S. Ramos, worked in the preparation of the land for 1956 and in the harvest of the 1955 crop, the family partnership was not to commence operation until January 1, 1956.

and fixes in the sum of $55,160.12 (25% of the crop income of $220,640.48).

(8) The absence of Joe S. Ramos in 1956 and for nine months in 1957 due to military service did not in any way affect the distributive share of the partnership income to which he would have been entitled but for such absence.

(9) The corrected income of the partnership for 1957 must be reallocated to credit plaintiffs with a reasonable salary for services rendered by the plaintiff, Joe R. Ramos, which the Court finds to be and fixes in the sum of $3,150.00 ($350.00 times nine months).

A further adjustment must be made on the rental value of the land, trees and equipment for 1957. Such adjustments, based upon the fact that the partnership operated on a cash basis and based upon the books of the corporation, reflects the need to correct the partnership income for 1957 by a deduction in rental of $11,240.67. (This deducted amount of rental was actually paid in 1958 and not 1957.)

The foregoing answers and the adjustment of rental for 1957 are amply supported by the record.

The documentary evidence offered and received in evidence, the testimony adduced and the stipulations entered into show no substantial factual conflict. The record in these cases presents matters of law arising from what is in practical effect an agreed statement of facts. (Tr. 215). All of the evidence in the case, oral and documentary, save and except Government's

Exhibit "A" was presented by plaintiffs. At the Government's request, all witnesses were excluded from the courtroom during the taking of testimony. At the conclusion of plaintiffs' case, the Government rested and did not offer any evidence either by way of oral or further documentary evidence. In this connection it should be noted that the farming and business activities of the partnership, as well as the acts and conduct, both business and personal, of the individuals involved, had been under close scrutiny and continuous investigation of government tax agents and investigators since December 1958 (Pltfs. Ex. 50). Also of significance is the government's frank and open concession that the testimony of the four witnesses, Ruben Lopez (Tr. 367-373), Charles Huff (Tr. 373-379), Frank Molina (Tr. 379-383) and Sam Silva (Tr. 383-390) as to their knowledge of the formation, conduct and existence of the 1956 family partnership "is fairly truthful" (Tr. 390a). The weight to be accorded such a record is well expressed in *Nicholas v. Davis,* 204 F. 2d 200, 202 (a tax refund case), wherein, in connection with a similar record, the Court said:

> When controlling, positive and uncontradicted evidence is introduced, and when it is unimpeached by cross-examination or otherwise, is not inherently improper, and no circumstance reflected on the record casts doubt on its verity, then under the principles laid down in *Chesapeake & Ohio Ry. Co. v. Martin,* 283 U. S. 209, 215-220, 51 S. Ct. 453, 75 L. Ed. 983, it may not be disregarded even though adduced from interested witnesses, and no question of credibility

or issue of fact is presented for determination by the jury.

See also: *Alabama Title & Trust Co. v. Millsap,* 71 F. 2d 518, 520; *S.F. Assn. for Blind v. Industrial Aid,* 152 F. 2d 532, 536.

The Partnership Background.

Joe R. Ramos was born in Spain and came to the United States just before his sixteenth birthday in 1925. He was not a man of formal education. His total schooling in Spain was five months and in the United States it consisted of about one month's study in preparation of his application for citizenship, which was granted to him in 1950 or 1951. In 1931 he married the plaintiff Mary Ramos at Auburn, California. Both of their children were born in Loomis, California; their daughter, Dolores Donaldson, on November 15, 1931, and their son, Joe S. Ramos, on September 17, 1934.

Joe R. Ramos had farmed on his own account in California since 1932, and prior thereto had worked as a ranch hand for others. In 1943 he purchased a 219 acre almond ranch at Winters, California, where he established the family at what became known as the "Ramos Home Ranch". At this time Dolores was about twelve and one-half years of age and Joe S. Ramos was about nine years of age. Throughout all their school years the children worked on the ranch. As they progressed in years, maturity and ability, they were responsible for and took on more and more of an active participation in the various ramifica-

tions of farming crops in and about the ranch (Tr. 10). While Dolores was in high school she began to learn bookkeeping in connection with the books of account and records of the ranch (Tr. 11). She was tutored in this work by Mr. Beverly Laugenour, the certified public accountant, who for many years was in charge of the books of account and responsible for the tax returns of Mr. and Mrs. Ramos (Tr. 11). Her brother, Joe S. Ramos, was carefully trained by his father in preparation for his eventual work as the "outside partner". Young Ramos' many years of apprenticeship were not confined to mere menial farm chores. To the contrary, he was meticulously and patiently instructed and trained by his father in all aspects of almond ranching, including the planting, shaping and cutting of trees (Tr. 421), spraying and pruning of trees (Tr. 421), contouring of land, placing of markers to indicate direction of levees (Tr. 423), pollenization (Tr. 423), and the hiring and recruiting of field workers (Tr. 27), including a trip to Mexico for such specific purpose (Tr. 372). This latter activity, bearing in mind young Ramos' knowledge of Spanish, was one of the most important aspects of the operation of the ranch because it had to do with the actual harvest of the crops. This training and work of his children was in preparation of and had for its definite objective the fulfillment of the clear intention, understanding and avowed purpose of Joe R. and Mary Ramos that when their son, Joe S. Ramos, reached his twenty-first birthday, a family partnership composed of all members of the family, would come into

being (Tr. 19, 145, 154, 421, 426-427). This idea and purpose was acted upon as early as 1946, when Joe R. Ramos sought the advice of their then attorney, Mr. Ford of Colusa County, as to the wisdom and propriety of forming a family partnership with his wife and children (Tr. 13).

It is not open to question that on numerous occasions the subject of a family partnership was discussed by and among members of the family, and that these discussions became more numerous and pointed as Joe S. Ramos approached his twenty-first birthday. It cannot be disputed that the finalizing of the agreement to form the partnership actually took place about the time Joe S. Ramos graduated from Sacramento Junior College in June 1955, and that immediately after graduation he went to work on a full-time basis at the home ranch in connection with the 1955 crop. Because of his draft status, and his status in the Naval Reserve, he entered the United States Navy, but deferred doing so until November 1955, at a time when the 1955 crop had been fully harvested (Tr. 23).

The plain and legitimate inferences which may properly be indulged in and drawn from the record in this case are that the Ramos family is an affectionate, close-knit, loyal and harmonious family, in which the virtues of filial respect, obedience and industry are the daily way of life; where the good things of life are worked for, nurtured and preserved for their enjoyment and natural passage from the parents to the children; "eventually that some day

they would take over the complete management themselves, the children". (Tr. 515).

As authority for its resolution of the ultimate facts as to the existence and operation of valid family partnerships for the years in question, this Court relies upon the principles enunciated in *Commissioner v. Culbertson*, 337 U.S. 733, 93 L. Ed. 1661, decided in 1949. The yardstick by which the trial court is to measure the "family" partnership is set forth at page 742 of the Chief Justice's opinion, wherein he declared:

> The question is not whether the services or capital contributed by a partner are of sufficient importance to meet some objective standard *supposedly* established by the *Tower* case, but whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on *their true intent—the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.* (emphasis supplied)

Again, at page 744 the Chief Justice went on to declare:

> Unquestionably a court's determination that the services contributed by a partner are not "vital" and that he has not participated in "management and control of the business" or contributed "original capital" has the effect of plac-

> ing a heavy burden on the taxpayer to show the bona fide intent of the parties to join together as partners. But such a determination is not conclusive, and that is the vice in the "tests" adopted by the Tax Court. It assumes that there is no room for an honest difference of opinion as to whether the services or capital furnished by the alleged partner are of sufficient importance to justify his inclusion in the partnership. *If,* upon a consideration of all the facts, *it is found that the partners joined together in good faith to conduct a business, having agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient.* The Tower case did not purport to authorize the Tax Court to substitute its judgment for that of the parties; it simply furnished some guides to the determination of their true intent. (emphasis supplied)

The record in the instant case amply meets the test laid down by the *Culbertson* case. In the words of the Supreme Court, "There is nothing new or particularly difficult about such a test."

If, on the instant record, the Court were to conclude that there was no true partnership in existence and operating during the years involved, it would be substituting its judgment for that of the parties. This record does not reflect "a misuse of the outward form of a partnership as a device for the obtaining of tax advantages". This Court finds that the parties, without thought of tax advantage, in fulfillment of a long-nurtured and oft expressed desire "in good faith

and acting for a business purpose" and a "community of interest in the profits and losses", joined together in the conduct of the almond orchard and farming activities of the Ramos Home Ranch. *This was their true intention* and the history of the partners in their actual operations during the last six months of 1955 and throughout 1956 and 1957 bears this out.

The 1956 Partnership.

The expressed intention of the parties to form a family partnership, although not to be operative until January 1, 1956, came into existence, as the parties intended for years, on September 17, 1955, which was the twenty-first birthday of the son, Joe S. Ramos. It was given meaning and expression as early as June of 1955 when young Ramos graduated from Sacramento Junior College. From the day of his graduation and until November of that year, when he enlisted in the Navy, young Ramos, with knowledge of the family partnership to be formed and formed on his twenty-first birthday and in preparation and anticipation of its operative effect on January 1, 1956, worked continuously on the ranch to complete the harvest and prepare for 1956 by fertilizing and spraying. His sister, Dolores, contributed her services as bookkeeper throughout 1955 and continuously thereafter in 1956 and 1957. The fact that she was also employed by the Pacific Gas and Electric Company did not detract in any way from her capacity to properly keep the books and records of the ranch, nor did it prevent her from enjoying the

status of a partner. It is a fair statement from the record that no partner worked "full time". This was necessarily so because the business was a seasonal business in many respects. Joe R. Ramos, the father, did not devote his entire time and attention to the ranch, but was engaged in other pursuits, business ventures other than the partnership.

The basic concept of a partnership is a group of persons having a common business interest, working together in their respective spheres toward the successful operation and conduct of that business interest. It does not connote the idea that each and every working partner must punch a clock at eight o'clock in the morning and work continuously through the day until five o'clock. Dolores devoted her energies, skill and ability toward the paper work of the partnership in all that was required of her and thereby fully performed her responsibility to the partnership. Young Ramos, after doing all he could to complete the 1955 harvest and to prepare for 1956, went into the Navy and thereafter continued to do everything he could within the limits of military service by keeping abreast of ranch affairs, giving advice on farming matters, expressing his concern over ranch operations and by working on the ranch during some of the days of his Christmas furlough. In 1957 he worked continuously on the ranch from the date of his discharge from the Navy on October 4, 1957 to the end of the year. In speaking of the arrangement with his father at the time of his enlistment, he said: "It was an understanding we had, that I had with my father, that he would take care of things while

I was gone and when I came back, I would make it up, and then he could take it easy." (Tr. 464-465).

Under the circumstances of this case wherein the partnership, pursuant to an oft expressed intention over the years, was created on September 17, 1955, even though not operative until January 1, 1956, the military service of young Ramos did not foreclose, was not intended to foreclose, and statutorily (26 U.S.C., 1958 ed., Section 704(a)(2)) could not foreclose his right to a distributive share of the partnership earnings. See: *Culbertson v. C.I.E.,* 168 F. 2d. 979; *Seabrook v. C.I.R.,* 196 F. 2d. 322; *Crossley v. Campbell,* 87 F. Supp. 862; *Anderson v. Robinson,* 115 F. Supp. 776; *Skarsky v. United States,* 153 F. Supp. 796, cases which are in accord with the conclusion reached by this Court, though the specific principle relating to absence because of military service was not discussed.

In reaching its conclusion this Court is not unmindful of the Government's reliance on the case of *Cain v. United States,* 135 F. Supp. 516. However, there are three significant facts in the *Cain* case which distinguish it from Ramos:

(1) That at the time of the Cain partnership young Cain had *already* received a commission as a probationary naval ensign *while still in dentistry school,* and prior to the signing of the agreement;

(2) That the partnership agreement took the precaution to provide that should the son die during his period of service all the property of the partnership would immediately revert to the father. This in

the face of the fact that at the time of the agreement young Cain was married. This indicates a lack of control of the son over his interest in the partnership because the fact of death would completely cut out his wife and all property would revert to the father;

(3) That the *Cain* case involved a partnership of a *strictly personal* service character.

Contrary to *Cain,* we have *Culbertson,* and the situation respecting the four Culbertson sons, whose partnership status was contested. The oldest son was twenty-four years of age, married, and living on the ranch, of which he had for two years been foreman under the Coon and Culbertson partnership. He was a college graduate and received $100.00 a month plus board and lodging for himself and his wife, both before and after the formation of Culbertson & Sons and until entering the Army. The second son was twenty-two years of age, was married and finished college in 1940, the first year during which the new partnership operated. He went directly into the Army following graduation *and rendered no services to the partnership.* The younger sons who were eighteen and sixteen years of age, respectively, in 1940, went to school during the winter and worked on the ranch during the summer. In a concurring opinion in *Culbertson,* Mr. Justice Burton at page 749 states:

> . . . The physical absence of some of the Culbertson boys from the ranch does not necessarily preclude them or others from the obligations or the benefits of the partnership for tax purposes.

> Their contributions of capital, their participation in the income *and their commitments to return to the ranch or otherwise to render service to the partnership are among the material factors to be considered. A present commitment to render future services to a partnership is in itself a material consideration to be weighed with all other material considerations for the purpose of taxation as well as for other partnership purposes.* (emphasis supplied)

The fact that the negotiations leading up to the 1956 partnership, and the partnership agreement itself, were oral, did not militate against the existence of the partnership, for as Joe R. Ramos expressed it, ". . . we understand we don't have to have papers between the family.". (Tr. 69) During this particular year the partners had not received any advice as to the formation of their business partnership and did not for a moment believe that there was any impropriety in continuing the business in the name of the father alone. As Mr. Laugenour, their then accountant, put it, "Although aware that a family partnership would be formed when the son, Joe S. Ramos, and the daughter, Dolores, were both of age, I took no technical interest in their discussions because there was in my opinion no action necessary to accomplish this relationship for the purpose of preparing income tax returns." (Pltfs. Ex. 89)

It is true that in 1956 no change had been made in the bookkeeping practices of the family, that, other than the use of the land, trees and equipment in what

the Court deems to have been a rental, there was no actual capital contribution, and separate partnership accounts were not maintained, yet there was no question as to the partnership and the nature thereof. This was expressed in the testimony of Dolores Donaldson, when she testified on cross-examination:

> Q. Well, what was your twenty-five percent interest in 1956?
>
> A. In the partnership agreement. When we formed it we were going to be partners, were going to be a family partnership, all together, and whatever income we made we would share.
>
> If we had losses, we would share them and we would pay your expenses, and whatever was left we would share twenty-five percent, my father, my mother, my brother and I. I don't think you have to own land to have a share in anything.
>
> Q. In other words, you feel you can participate in the profits from the land without owning any portion of the land?
>
> A. Yes.
>
> Q. And this is the type of partnership interest you had, just in the profits generated by assets?
>
> A. Profits or losses that would be produced by the almond trees on the land. (Tr. 301-302)

Even though there was no bookkeeping separation of the partnership business from the rest of the family business, the books were adequate and clearly reflected what were to be considered as partnership items and what were to be considered as items personal to Joe R. and Mary S. Ramos. The business operations on the home ranch in connection with the

almond crop were not of particular magnitude and did not involve the intricacies and complexities inherent in a big business. On the subject of bookkeeping records in connection with farming activities, it has been stated in *Britt's Estate v. C.I.R.*, 190 F 2d. 946:

> As to the bookkeeping records, farming is not a type of business in which elaborate records are usually kept. Nor are the members of a family, when dealing inter se, as likely to observe formalities as strictly as when dealing with others. Spurious agreements, designed to evade taxes, are frequently in better form than genuine ones. The records here kept were adequate and appropriate for the purpose, and present no evidence of distortion or concealment of facts.

This almond crop business, which was well suited to the Ramos family, was operated and carried out in the utmost good faith, in accordance with their partnership agreement, with each of the partners exercising dominion over the business in their respective spheres and participating in the earnings thereof in accordance with their respective interests. The partnership distributive shares were received and used and controlled by the partners with complete independence and have continued ever since to be so received, used and controlled. The 1956 partnership returns for both the federal and state governments were made in accordance with the agreement, and subject to adjustments hereinabove and hereinafter set forth, strictly and accurately reflected the distributive share of each partner.

The 1957 Partnership.

Without going into any greater detail than necessary, the record clearly reflects a valid formalized family partnership agreement between Joe R. Ramos, Dolores Donaldson and Joe S. Ramos for the year 1957. Except for the formalization of the agreement and the fact that it was limited to Joe R. Ramos, Dolores Donaldson and Joe S. Ramos, the 1957 agreement was essentially the same agreement that existed in 1956. The man instrumental in the formalization of the family agreement was Mr. Franzman, a certified public accountant, who in 1956 succeeded Mr. Laugenour as the family accountant. After reviewing with the family the entire family operation in 1956, he testified further at page 486 as follows:

> Q. Yes, and do you know who was instrumental in having the change made?
>
> A. Well, I guess I was.
>
> Q. All right, tell us about that.
>
> A. Well, one of the first questions I asked all the members of the family, whether there was a written partnership agreement on this, and I found out there was none, so I said "Well, in my opinion, we should firm up this a little more. It's fine what's in your hearts, yes, it's a partnership within your heart or the heart of each of you, but for legal purposes we probably should firm it up a little. Something might happen to you, might happen to Joey, Dolores—You don't know, you don't know what you might get involved in." So I suggested some type of a partnership agreement be drawn up.

Thereafter a partnership agreement was drawn up with each of the partners making an initial capital contribution of $15,000.00, for a total of $45,000.00. As the exhibits reflect, the partnership agreement was followed by such documents as Memorandum of Rent Agreement, Certificate of Transacting Business Under Fictitious Name of "Joe R. Ramos & Co.", Affidavit of Publication, together with the opening of partnership commercial and savings accounts and original books of account and bookkeeping records of Joe R. Ramos & Co. Without going into further detail, it can be said that the proof of the 1957 partnership is replete with indicia pointing to the fact that the producing, harvesting and sale of the 1957 almond crop was conducted as a family partnership enterprise. It is clear:

(1) That the partnership operations were conducted in accordance with recognized business practices and pursuant to the intent of the parties;

(2) That each of the partners made capital contributions of $15,000.00, and that these respective capital contributions were necessary to and were utilized by the partnership in connection with the 1957 operations;

(3) That the partners Joe R. Ramos and Dolores Donaldson each rendered services to the partnership in accordance with their previous understandings and agreements and did the work allocated to them; and

(4) That the partner Joe S. Ramos, by reason of his military service, was not able to be physically

present in connection with the 1957 farming operation until his discharge on October 4, 1957, and that he then immediately went to the ranch, without any time off or vacation, and worked straight through to the end of the year. As heretofore stated, Joe S. Ramos was a partner, and his military service in no way served to diminish and was never intended to have the effect of diminishing his distributive share in the partnership earnings.

Having found a valid family partnership for 1956 and a valid family partnership for 1957, the Court, in determining the amount of overpayment, must now give consideration to the adjustments to be made to establish the corrected partnership income for each of these years and the manner in which the income should be allocated among the partners. *The Reallocation of Receipts from Crops Sold in Prior Years. Depreciation and Property Taxes, Rental and Services of Joe R. Ramos.*

In 1956 the Ramos family partnership reported as part of its gross income the sum of $70,640.48 received for almonds raised on plaintiffs' ranch and sold in 1955 *before* the partnership was to become operative. Similarly, the partnership for 1957 reported as part of its gross income the sum of $157,088.71 received for almonds and peaches (the receipts for peaches amounted to only $152.00) raised by the 1956 partnership in its operation and sold and delivered to the buyer in 1956. Although the plaintiffs and the partnerships for 1956 and 1957 were on a cash basis, the fact remains that the receipts in 1956 for crops raised

in 1955 represented *earnings of the plaintiffs,* and the receipts in 1957 for crops raised in 1956 represented *earnings of the 1956 partnership.*

It is basic that income from services is taxable to the person who renders the services, and that income from property is taxed to the person who owns or controls the property. Moreover, this basic concept, which has been applied to Section 61 of the Internal Revenue Code of 1954 and similar provisions of prior revenue acts, cannot be defeated by a transfer or assignment before the income is realized. The $70,640.48 received in 1956 for crops sold in 1955 represented income earned exclusively by the plaintiffs and generated by their services and by property owned and controlled by them. The 1956 partnership contributed nothing to the earning or creation of this income. Similarly, the $157,088.71 received in 1957 for crops sold in 1956 represented income earned exclusively by the 1956 partnership and generated by services of and property controlled by the 1956 partnership. The 1957 partnership contributed nothing to the earning or creation of this income.

The plaintiffs, *having earned* $70,640.48 for crops sold in 1955, cannot defeat or avoid their tax liability by assignment to the 1956 partnership, and the 1956 partners, *having earned* $157,088.71 for crops sold in 1956, cannot defeat or avoid their tax liability therefor by assignment to the 1957 partnership. For cases in accord, see: *Lucas v. Earl,* 281 U.S. 111 (1930); *Helvering v. Horst,* 311 U.S. 112 (1940); *Helvering v. Eubank,* 311 U.S. 122 (1940); *Anthony's Estate v.*

Commissioner, 155 F. 2d 980 (10th Cir. 1946); *Austin v. Commissioner,* 161 F. 2d 666 (6th Cir. 1947), cert. denied 332 U.S. 767; *Palmer v. Commissioner,* 267 F. 2d 434 (9th Cir. 1959), cert. denied 361 U.S. 821; *Williamson v. United States,* 292 F. 2d 524, 528 (Ct. Cl. 1961).

It is evident that the 1956 partnership never owned the actual property upon which depreciation and property taxes deductions were claimed by the partnership in its 1956 returns. These deductions, amounting to $7,596.88 and $2,026.80, respectively, must be and are eliminated as deductions of the partnership and become personal expenses of the plaintiffs.

Salary allowances having been made to Dolores Donaldson for her actual services in 1956 and 1957 and to Joe S. Ramos for his actual services in the last three months of 1957, and the nature and quality of the services rendered by Joe R. Ramos in 1956 and for nine months of 1957 being at least comparable to those rendered by his son, the Court finds and directs that such reasonable salary allowances must be and are credited to Joe R. Ramos in the sum of $4,200.00 for 1956, and in the sum of $3,150.00 for nine months of 1957.

Finally, adjustments must be made in the rental of the land, trees and equipment used in the production and harvesting of the almond crops. As observed in Note 1 of this opinion, since all that the partnership received in 1956 from the plaintiffs was the use of the land, trees and equipment needed for the almond

orchard operation, such use should be and is treated as a rental rather than a capital contribution, and the reasonable value thereof, as expressed in the 1957 agreement, is twenty-five percent of the crop income. This Court now, therefore, finds and fixes such rental for the year 1956 in the sum of $55,160.17 (twenty-five percent of the crop income for 1956 in the sum of $220,640.48). For the year 1957, as previously stated in this opinion, the corrected partnership income should show a deduction in rental for that year in the sum of $11,240.67.

Consonant with its rulings and findings, the Court now sets forth what it deems to be appropriate schedules reflecting the corrected income of the partnerships for 1956 and 1957.

1956

The corrected partnership income for 1956 is $161,787.12. This amount has been determined as follows:

Receipts:		
From 1955 crops		$ 70,640.48
From 1956 crops		150,000.00
Receipts per 1956 tax return		$220,640.48
Expenses:		
Expenses per 1956 tax return	$ 68,477.04	
Deduct depreciation	(7,596.88)	
Deduct property taxes	(2,026,80)	58,853.36
Corrected income for 1956		$161,787.12

To accord with the views previously expressed by the Court, this corrected income should be allocated to Joe R. and Mary Ramos and their children as follows in computing the judgment herein:

Joe R. and Mary Ramos:		
Receipts from 1955 crops	$ 70,640.48	
Rent (25% of 1956 receipts)	55,160.12	
12 months' salary ($350.00 per month)	4,200.00	
50% of unallocated balance	14,993.26	$144,993.86
Forward		$144,993.86
Joe S. Ramos:		
25% of unallocated balance		7,496.63
Dolores Donaldson:		
25% of unallocated balance	$ 7,496.63	
12 months' salary ($150.00 per month)	1,800.00	9,296.63
Total		$161,787.12

In computing the judgment, Joe R. and Mary Ramos would also be entitled to a deduction from their distributive share of 1956 income for depreciation and property taxes of $9,623.68, which were eliminated in correcting the partnership income for that year. These were personal expenses of the plaintiffs, since the assets remained their property.

1957

The corrected partnership income for 1957 is $114,972.46. This amount has been determined as follows:

Receipts:		
From 1956 crops (almonds and peaches)		$157,088.71
From 1957 crops and other sources		37,117.74
Receipts per 1957 tax return		$194,206.45
Expenses:		
Expenses per 1957 tax return	$ 91,524.66	
Deduct rent paid in 1958	(11,240.67)	
Deduct Joe S. Ramos drawing for 3 months	(1,050.00)	79,233.99
Corrected income for 1957		$114,972.46

As with 1956, this corrected income should be allocated to Joe R. and Mary Ramos and their children as follows in computing the judgment:

Joe R. and Mary Ramos:		
50% of 1956 crop receipts (almonds only, with adjustment of $152.00 for peach crop)	$ 78,468.35	
9 months' salary ($350.00 per month)	3,150.00	
33⅓% of default balance	(15,988.09)	$ 65,630.26
Joe S. Ramos:		
25% of 1956 crop receipts (almonds)	$ 39,234.18	
3 months' salary ($350.00 per month)	1,050.00	
33⅓% of deficit balance	(15,988.08)	24,296.10
Dolores Donaldson:		
25% of 1956 crop receipts (almonds)	$ 39,234.18	
12 months' salary ($150.00 per month)	1,800.00	
33⅓% of deficit balance	(15,988.08)	25,046.10
Total		$114,972.46

In computing the judgment herein, plaintiffs should also adjust their rental income from Joe R. Ramos & Co. to eliminate the rent paid in 1958.

This opinion shall constitute the findings of fact and conclusions of law of the Court. Based thereon and the schedules above set forth, the parties are directed to compute the refunds due plaintiffs for the year 1956 and 1957 and submit an appropriate judgment to the Court.

Dated: June ....., 1966.

Alfonso J. Zirpoli
United States District Judge

In the United States District Court for the Northern District of California

Joe R. Ramos and Mary Ramos, Plaintiffs, vs. United States of America, Defendant.	Civil Actions No. 40033 and No. 40202

AMENDMENT TO MEMORANDUM OPINION AND ORDER

The Court, at the request of counsel, has reviewed the allocation of income for the 1956 partnership involved in the above actions. It appears that the Court used as the measure of rent for 1956 gross receipts of $220,640.48, whereas the correct partnership gross receipts for that year were only $150,000. The Court therefore modifies and amends its June 22, 1966 Memorandum Opinion and Order to find and fix as rental allocable to plaintiffs for 1956 the sum of $37,500 in lieu of the amount previously set forth.

In accordance with this amendment, the income for the 1956 partnership should be allocated as follows in computing the amount of the judgment to be entered herein:

Joe R. and Mary Ramos:		
Receipts from 1955 crops	$ 70,640.48	
Rent (25% of receipts from 1956 crops)	37,500.00	
12 months' salary ($350.00 per month)	4,200.00	
50% of unallocated balance	23,823.32	$136,163.80
Joe S. Ramos:		
25% of unallocated balance		11,911.66
Dolores Donaldson:		
12 months' salary ($150.00 per month)	$ 1,800.00	
25% of unallocated balance	11,911.66	13,711.66
Total		$161,787.12

In computing the judgment, Joe R. and Mary Ramos would also be entitled to a deduction of $9,623.68 from their distributive share of 1956 partnership income for depreciation and property taxes which were eliminated in correcting that partnership income.

In all other respects, the Memorandum Opinion and Order entered herein on June 22, 1966 shall remain unchanged.

Dated: September ....., 1966.

Alfonso J. Zirpoli
United States District Judge

Appendix "B"

United States Court of Appeals
for the Ninth Circuit

United States of America, Appellant and Cross-Appellee, vs. Joe R. Ramos and Mary Ramos, Appellees and Cross-Appellants.	No. 21,824 No. 21,824 A

[April 10, 1968]

On Appeal from the United States District Court
for the Northern District of California

Before: CHAMBERS, JERTBERG and ELY,
Circuit Judges.

JERTBERG, Circuit Judge:

Before us are two family partnership cases. Both involve federal income tax claims,—one for the year 1956, and the other for the year 1957. The two cases were consolidated for trial in the district court, and are before this court on a consolidated record.

In the first case, the Commissioner of Internal Revenue determined that the entire income from a partnership allegedly entered into and existing during the year 1956, by and between Joe R. Ramos and Mary Ramos, his wife, appellees, (Joe R. Ramos being hereinafter sometimes called "taxpayer"), and

their son and daughter, Joe S. Ramos and Dolores Donaldson, respectively, must be taxed to the appellees. In the second case the Commissioner of Internal Revenue determined that the entire income from a partnership allegedly entered into and existing during the year 1957, by and between Joe R. Ramos and his son and daughter, must be taxed to the appellees.

The deficiencies assessed in each case were paid, and claim for refunds were filed and rejected. Within the time provided in § 6532 of the Internal Revenue Code of 1954, appellees instituted actions in the district court for the recovery of taxes paid for the years 1956 and 1957.

The cases were tried to the court sitting without a jury. Following trial the district court held that a valid family partnership existed during 1956, composed of appellees and their two children, and that a valid family partnership existed during 1957 composed of taxpayer, Joe R. Ramos, and the two children. The district court also determined the "corrected" partnership income and the distributive shares of the partners on the basis of various adjustments, including the allowance of twenty-five percent of the crop receipts as rent owing to appellees by the partnership for the two taxable years, and the allocations in equal amounts among members of the 1956 partnership of the sum of $157,088 received in 1957 from crops sold in 1956.

The Government appeals from the judgment entered by the district court, and the appellees cross-appeal from certain portions of said judgment.

The district court and the parties to this appeal are in agreement that the basic facts disclosed by the record are virtually undisputed. Our review of the record and examination of the briefs cause us to adopt, as the basic and relevant facts, the statement of facts which appear in the brief filed by the Government, as appellant. We find nothing in the briefs filed by the appellees which takes serious issue with such statement.

The statement, with slight editing on our part, is as follows:

Taxpayers, Joe R. and Mary Ramos, are husband and wife and reside on a 219-acre ranch near Winters, California. They purchased this ranch in the latter part of 1943 and have lived on and farmed it continuously from that time. Approximately 175 acres of the ranch are planted in mature almond trees with the balance being planted in peaches and olives. The land, trees and other improvements which comprised the taxpayers' ranch and the equipment necessary for its operation had a value of $200,000 to $230,000 during 1956 and 1957, the years in suit.

Taxpayers' daughter, Dolores Donaldson, was 24 years old in 1956 and by that year had graduated from Sacramento Junior College and was married. From the time she was in high school, Dolores had done the bookkeeping for the ranch as well as for her parents' other business ventures. She was paid for these services and in 1955 received $75 for this work.

Taxpayers' son, Joe S. Ramos, had worked on taxpayers' ranch on weekends and during vacations from school. From the time he graduated from high school, he was paid for his work. After he graduated from Sacramento Junior College in June 1955, he worked on the ranch and was paid accordingly. On November 22, 1955, Joe S. Ramos went on active duty with the United States Navy and was shortly thereafter transferred to Hawaii. At the beginning of the period in suit, Joe S. Ramos was 21 years old.

Taxpayer's brother, Frank D. Ramos, was foreman of the ranch prior to the years in suit and throughout the period Joe S. Ramos was in the Navy.

As of January 1, 1956, a "family partnership" composed of the taxpayers and their children, Dolores Donaldson and Joe S. Ramos, purportedly was to commence. This partnership was to operate taxpayers' ranch for the year 1956, with each of the four partners having a 25 percent interest in the business. The partnership acquired no interest in the land, trees and other improvements which made up the taxpayers' ranch or in the equipment necessary for its operation, as these assets were retained by taxpayers. The partnership did not pay any rent in 1956 for these assets. Neither Dolores Donaldson nor Joe S. Ramos contributed any capital to the partnership for 1956.

During 1956, the ranch continued to operate under the name of "Joe R. Ramos." The expenses for operating the ranch for that year were paid from tax-

payers' joint checking account with the Bank of America at Winters, with the receipts from the operation of the ranch being deposited to that account. This account included funds other than partnership funds. The accounting records for the 1956 ranch operations were kept on the cash basis and were merely a continuation of the individual records maintained for taxpayers in previous years.

The 1956 federal employer's withholding tax return for the ranch employees was filed in the name of "Joe R. Ramos, owner" and under the account number assigned to him. On January 28, 1958, Dolores Donaldson advised the District Director that the employer's return for 1956 should have been filed under the name and account number for "Joe R. Ramos & Co." However, that account number was not applied for until November of 1957 and was obtained for a partnership that did not include Mary Ramos as a partner. The workmen's compensation report for that year was also filed under taxpayer's name.

Because of his experience, taxpayer was senior partner and "boss" of the partnership. He made the decisions concerning the sale of crops grown on the ranch and generally supervised the ranch operations. However, he received no salary or allowance for his work.

Taxpayers' daughter, Dolores, lived in Winters with her husband and worked full time throughout 1956 as a clerk for Pacific Gas & Electric Company. As

compensation for doing the bookkeeping for the partnership on a part-time basis, she received $150. She was also paid $35 for two days' field work.

Taxpayers' son, Joe, was on military duty in Hawaii during 1956 with the exception of the last week in December. During that brief stay at home, he did not do any work on the ranch.

The 1956 almond crop was sold on June 26, 1957, by Joe R. Ramos as the seller.

For 1956, the partnership filed a federal partnership information return in the name of "Joe R. Ramos Co." This return was filed on the cash basis and reflected total receipts of $220,640.68, of which $70,640.48 represented proceeds from the almond crop grown on taxpayers' ranch and sold in 1955. The return further reflected expenses of $68,477.04, including depreciation and real property taxes on assets belonging to taxpayer. The net income of $152,163.44, as shown on the return, was divided into four equal shares of $38,040.86, which shares were reported by the purported partners on their individual returns for 1956.

Dolores Donaldson's distributive share of the partnership's profit for 1956 was paid to her on February 14, 1957. She then paid $16,028.68 to the Internal Revenue Service in payment of her federal income taxes for 1956. In addition, she paid $1,160.34 to the Franchise Tax Board of the State of California in payment of her 1956 state income tax.

Payment of the distributive shares of Joe S. Ramos, who was then in Hawaii, was handled as follows:

$17,472.56 was paid to the Internal Revenue Service from taxpayers' joint checking account for their son's 1956 federal income taxes and $19,173.85 was deposited to a savings account maintained in the names of "Ramos, Joe S. or Joe R." in the form of a check drawn on taxpayers' joint account. Taxpayer then withdrew $2,217.75 from the account he had with his son to pay state and additional federal income taxes for Joe S. Ramos for 1956.

For 1957, a different partnership was purportedly organized to operate taxpayers' ranch. A written agreement was entered into by taxpayer and his son and daughter which provided that they would engage in the farming business under the name of "Joe R. Ramos & Co." until January 1, 1962, and that each would receive 33⅓ percent of the profits. Mary Ramos was not a party to this agreement and was not to be a partner in 1957. The partnership agreement in pertinent part, further provided:

> 3. *Capital.* The capital of the partnership shall be contributed by the partners, in cash as follows:
>
> | | |
> |---|---|
> | Joe R. Ramos | $15,000.00 |
> | Dolores Donaldson | $15,000.00 |
> | Joe S. Ramos | $15,000.00 |
>
> The foregoing capital consists entirely of cash and represents the entire assets of the partnership at the commencement of the calendar year 1957.
>
> * * * * *
>
> 5. *Salaries of Working Partners.* Joe R. Ramos shall devote full time and attention to the partnership business, and upon his release from mili-

tary service, Joe S. Ramos will devote such time and attention to the partnership business as he is able. Dolores Donaldson shall render bookkeeping services for the benefit of the partnership. And each of the partners shall receive such monthly salaries as may from time to time be fixed by mutual agreement between them, such salaries to be an allowance of reasonable compensation for services actually rendered to the partnership. Notwithstanding the foregoing, the amount of such salaries shall be subject to the provisions of paragraph ..... hereof.

* * * * *

7. *Drawing Accounts.* * * * Except as otherwise specifically provided herein, no part of the capital contribution of the partners shall be withdrawn without the unanimous consent of the partners.

8. *Management.* The partnership business shall be managed by the working partners, but in the event of any disagreement between them, the decision of Joe R. Ramos shall be controlling.

9. *Restrictions on Partners.* * * * No partner shall, except with the consent of the other partners, assign, mortgage or sell his share in the partnership or in its capital assets or property, or enter into any agreement as a result of which any person shall become interested with him in the partnership, * * * * * *

10. *Banking.* All funds of the partnership shall be deposited in its name in such checking account or accounts as shall be designated by the working partner or partners. All withdrawals therefrom are to be made upon checks signed by Joe R. Ramos.

As in 1956, the land, trees and improvements which made up taxpayers' ranch and the equipment necessary for its operations were not transferred to the partnership. However, about the same time the 1957 partnership agreement was signed, a Memorandum of Rental Agreement was entered into by all partners on behalf of "Joe R. Ramos & Co." and by the taxpayers individually. This agreement provided:

> Joe R. Ramos & Company, a partnership will rent from Joe R. Ramos and Mary S. Ramos, for a two-year period commencing November 1, 1956 and terminating November 1, 1958, approximately 175 acres located near Winters and belonging to the owners. The rent to be paid to owners shall be 25% of the gross sale price of the crops raised thereon during the term and the partnership shall pay all expenses except real property taxes and machinery costs, said machinery to be supplied by owner, except that minor repairs to machinery for maintenance and less than $100.00 shall be paid by the partnership.

Until the end of March, 1957, banking for the partnership was handled through taxpayers' joint account with the Bank of America at Winters. At that time, taxpayer and his son and daughter each contributed $15,000 to the partnership. The contributions of Dolores and Joe S. in 1957 were derived from the profits of the 1956 partnership. The actual mechanics of making these contributions involved the issuance of checks to the children from taxpayers' account with the Bank of America at Winters, the depositing of these checks to accounts maintained by the children, and the purchasing of cashier's checks for the funds

actually deposited to the account opened in the name of "Joe R. Ramos & Co." with the First National Bank of Dixon. These contributions were deposited to the account of "Joe R. Ramos & Co." which was opened at the First National Bank of Dixon. This account and a savings account subsequently opened in the same name could be drawn upon only by Joe R. Ramos or Mary Ramos.

The partnership books for 1957 were kept on the cash basis and in substantially the same form as the books kept for taxpayers in previous years. A similar set of books was also kept for taxpayers in 1957.

For 1957, business was done mainly in the name of "Joe R. Ramos & Co." A fictitious name certificate listing the purported partners was executed in July of that year and filed with the County Clerk of Solano County in Fairfield, California, but was not published until September in a local newspaper. The 1957 almond crop was sold under a contract made by "Joe R. Ramos & Co." as seller and payments were made in that name by the purchaser. The federal employer's withholding tax return was filed under the account number obtained for the 1957 partners and the workmen's compensation report for 1957 was also filed in the partnership name.

Dolores Donaldson, in acting as bookkeeper for the 1957 partnership, did essentially the same work which she had done in prior years for taxpayers. Taxpayers' son was not separated from the Navy until October of 1957 and worked on the ranch for only the last three months of the year. He received a salary of $350 per month during this period.

For 1957, a federal partnership information return was filed on the cash basis in the name of "Joe R. Ramos & Co." This return reflected total receipts in the amount of $194,206.45, including $157,088.71 from almonds and other crops which were raised, sold and delivered in 1956. Rent to Joe R. Ramos in the amount of $48,480.08, and other expenses of $43,044.58 were deducted from the total receipts to arrive at a net income of $102,681.79 for the year. The sum of $48,480.08 was paid by partnership receipts of $30,000 and $7,239.41 which taxpayer withheld as advance rent, and a check for $11,240.67 which was drawn by the partnership in 1958. The sum of $48,480.08 was approximately 25 percent of the gross crop receipts received in 1957 and was determined without regard to the period in which the crops were grown, whereas the rental agreement purportedly in effect for 1957 provided for only 25 percent of the gross receipts for crops grown on the premises after November 1, 1956.

Dolores Donaldson and Joe S. Ramos each reported $34,227.25, or one-third of the partnership net income, on their individual federal income tax returns for 1957. Taxpayers reported the remaining one-third of the net income and rent in the amount of $48,480.08 on their 1957 federal income tax return.

On February 6, 1958, Dolores Donaldson and Joe S. Ramos each received $15,000 as a partial distribution of the profit reported by the partnership for 1957. No other payments were made to either of them for the remainder of their 1957 distributive shares.

On February 10, 1958, Dolores Donaldson and her husband paid a total of $14,622.98 for 1957 federal and state income taxes due in addition to the taxes withheld from their salaries. On the same day, Joe S. Ramos and his wife paid 1957 federal and state income taxes totaling $12,343.30.

We first consider the validity of the oral "family partnership" claimed to be in existence for the year 1956. Preliminarily, we recognize that for several years prior to 1956, the members of the Ramos family had discussed, and intended to enter into, a family ranching partnership when the son became twenty-one years of age. We do not doubt that they intended to enter into a family ranching partnership for the year 1956. More than intention, however, is required to effectuate such purpose.

It is evident that neither the son nor daughter contributed any capital to the claimed partnership. The son contributed no significant services during the year 1956. He went on active duty with the Navy in the fall of 1955, and shortly thereafter was transferred to Hawaii where he remained throughout 1956, with the exception of the last week in December when he was home on a short leave, at which time he did not work on the ranch. The daughter, who throughout the year was a full-time employee of Pacific Gas and Electric Company, did the bookkeeping for the claimed partnership, and was paid $150.00 for such services. She rendered the same service to her parents for the year 1955 and received payment for such services in the sum of $75.00. No rent was paid by the

partnership to the parents for the land and equipment. The father supervised the farming operations for which no compensation was paid to him by the partnership for such services.

Hence, we have before us a claimed family partnership in which the parents retained ownership and control of the income producing properties, and to which the children contributed neither property or services except the bookkeeping services of the daughter, for which services she was compensated.

In order to sustain their position, the taxpayers seek the benefits provided by §§ 191 and 3797(a)(2) of the Internal Revenue Code of 1939, as added and amended, respectively, in 1951 (Rev. Act 1951 § 340, 65 Stat. 452, 511), now embodied in Section 704(e) of the Internal Revenue Code (26 U.S.C. § 704(e)). Section 704(e) provides:

> "(e) *Family partnerships.*—
>
> (1) *Recognition of interest created by purchase or gift.*—A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.
>
> (2) *Distributive share of donee includible in gross income.*—In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for serv-

ices rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) * * *."

These sections were dealt with by this court in *Kuney v. Frank,* 308 F.2d 719 (9th Cir. 1962), at p. 721, where it is stated:

"These provisions recognize the principle that earnings are taxed to him who earns them, and the principle that income from capital, however acquired, is attributable to its owner. They eliminate, as a factor to be considered in determining the bona fides of a family partnership, the fact that the new partner acquired his interest by gift, and that he may be an inactive partner."

In support of their position taxpayers state in their brief:

"The Government's statement that neither the daughter nor the son contributed any capital to the partnership in 1956 is again unwarranted. The daughter and son having each acquired a 25% interest in and to the 'crops business' contributed that 25% interest to the partnership; the 'crops business' consisting of the right of use and control of the trees, lands and equipment, together with all accounts receivable of the said business and each of the children then contributed their said 25% interest in and to the right of use, control, possession and enjoyment

of the said lands, trees and equipment and the 25% interest each in and to the accounts receivable of the business during the 1956 partnership. We respectfully submit that the documents representing ownership of the lands, trees, equipment and accounts receivable could of themselves produce nothing. It is the use and control of the lands, trees and equipment and the accounts receivable of the business which produce either profit or loss. These are rights of substantial economic value. The accounts receivable of the business at the time of the creation of the partnership on September 17, 1955 were in the sum of $70,640.48. It is thus apparent that each child in contributing his interest in the account receivable in effect made a capital contribution to the partnership of $17,460.12 each, and that this $17,460.12 contributed by the son and the daughter was commingled with and was actually used in the operation of the ranch. Their contributions, therefore, were of a definite economic value to the partnership."

The record furnishes no support for such contentions. In this respect we again quote from the taxpayers' brief:

"Perhaps the most expressive statement of the existence and operation of the 1956 partnership is to be found in the testimony of Mrs. Dolores Donaldson as elicited on cross-examination:

'Q. That is essentially all he gave you on the ranch in '56, wasn't it, just an interest in the profits?

A. No.

Q. What was your interest? You didn't own land, did you Mrs. Donaldson, or any interest in the land?

A. No, we don't own the land.

Q. You don't own any interest in the machinery?

A. No.

Q. There was no cash capital put into the partnership in '56?

A. No.

Q. Well, what was your twenty-five per cent interest in 1956?

A. In the partnership agreement. When we formed it we were going to be partners, were going to be a family partnership, all together, and whatever income we made we would share.

If we had losses, we would share them and we would pay our expenses, and whatever was left we could share twenty-five per cent, my father, my mother, my brother and I. I don't think you have to own land to have a share in anything.

Q. In other words, you feel you can participate in the profits from the land without owning any portion of the land?

A. Yes.

Q. And this is the type of partnership interest that you had, just in the profits generated by the assets?

A. Profits or losses that would be produced by the almond trees on the land.'" (Emphasis omitted.)

Thus, the daughter's statement reveals that the children received no interest whatever in the assets of the farming operation. Therefore, they were thus unable to contribute to the partnership that which they, themselves, did not have. The parents retained complete interest in the operating assets of the ranch.

Now we consider the validity of the written "family partnership" agreement claimed to be in existence for the year 1957. The 1957 agreement was in writing, instead of oral as in 1956. The pertinent provisions of this agreement are set forth earlier in this opinion.

Under this agreement each partner was required to contribute $15,000.00, and the aggregate amount of such contributions was to represent the entire assets of the partnership at its commencement. Taxpayer, Joe R. Ramos, was required to devote full time and attention to the business. His son, Joe S. Ramos, was still in the military service and upon his release therefrom was to devote such time and attention to the partnership business as he is able. Taxpayer's daughter, Dolores Donaldson, was to render bookkeeping services to the partnership. In the event of any dispute or disagreement between the partners, the decision of taxpayer was to be controlling, and all disbursements from the partnership bank account were to be withdrawn only upon checks signed by the taxpayer.

A two-year rental agreement was entered into, under which the partnership would lease from the taxpayers the ranching property and farming equipment belonging to the taxpayers,—the rental for the two-year term to be in the amount of twenty-five per cent (25%) of the gross sales price of the crops raised. The partnership would pay all expenses except real property taxes and machinery costs, except for minor maintenance repairs to machinery.

The cash contribution of the children, to the capital of the partnership, was made at the end of March 1957, and such contributions were derived by them from the profits of the 1956 partnership income. Funds of the partnership were in the name of the partnership in a commercial and a savings account. Checks on such accounts could be drawn only by either the father or mother.

Taxpayers' son was not separated from the Navy until October of 1957, and rendered no significant service to the partnership except for the last three months of the year, for which he was compensated at the rate of $350.00 per month.

As in 1956, the taxpayers retained ownership and control of the income producing properties during 1957. The father again supervised the farming operations for which no compensation was paid to him by the partnership for such services.

The economic relationships of the parties remained the same as in the claimed family partnership for 1956, unless it can be said that the contribution of each child of $15,000 to the capital of the partnership, in March 1957, was significant. The capital contributions of the children were derived from the profits of the 1956 partnership and were originally paid out of taxpayers' joint account and finally deposited in another bank account which taxpayers alone could draw upon. The procedure followed with respect to such withdrawal and deposit appears earlier in this opinion. The checking account which was opened with the capital contributions by the children and a $15,000

contribution by the taxpayer never fell below $40,000, and approximately $70,000 in partnership receipts were placed in a savings account and left untouched for the remainder of the year. Less than a month before, the taxpayer withdrew $30,000.00 as "advance rent." It is clear that the capital contributions of the children were not needed or utilized that year. In these circumstances we see no other purpose for the capital contributions of the children except to create the appearance of a change in the economic relationships of the parties.

The district court found that a valid partnership existed between the father, the mother and the two children for the year 1956, and that a valid partnership existed between the father and the two children for the year 1957.

The government contends that each of said findings is "clearly erroneous."

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been made." *United States v. Gypsum Co.*, 333 U.S. 364, at 395 (1947).

We are mindful that ordinarily the question as to whether a family partnership is valid is one of fact, not of law. *Commissioner v. Culbertson*, 337 U.S. 733 (1949). However, as is true of any other question of fact, where all the relevant and material evidence directs us to but one conclusion, such conclusion must follow as a matter of law. See *Kuney v. Frank, supra.*

Here the evidence compels the conclusion that the family arrangements, in each year, created only an anticipatory assignment to the children of future income from property owned and controlled by the parents, and the services of taxpayer.

As stated in *Commissioner v. Culbertson, supra,* at pp. 739-40:

> "To hold that 'Individuals carrying on business in partnership' includes persons who contribute nothing during the tax period would violate the first principle of income taxation: that income must be taxed to him who earns it. *Lucas v. Earl,* 281 U.S. 111 (1930); *Helvering v. Clifford,* 309 U.S. 331 (1940); *National Carbide Corp. v. Commissioner,* 336 U.S. 422 (1949)."

In our view the findings of the district court above stated are "clearly erroneous." Our review of the entire record in this case leaves us with the definite and firm conviction that the district court was mistaken in each of said findings.

Our holding that each of the partnerships is invalid makes it unnecessary for us to review those portions of the judgment entered by the district court relating to the determination of the "corrected" partnership income and the distributive shares of the partners on the basis of various adjustments appearing in the judgment, and renders moot the cross-appeal of appellees as to certain portions of such judgment, and requires a dismissal of the cross-appeal for mootness.

The judgment of the district court is reversed and the cross-appeal is dismissed as moot.